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NEW NETWORKS

TIME TO CLEAN HOUSE: GETTING NEW YORK AND AMERICA WIRED, OPENING THE NETWORKS TO COMPETITION AND PROTECTING THE RIGHTS OF CUSTOMERS.

We are at the end game in telecommunications regulation in New York State and America. After the Sandy storm that ravaged the East Coast, including parts of New York State, Verizon, the incumbent utility telecommunications provider, claimed that it was no longer economical to repair damage to existing copper-based communications networks in some locations. Verizon filed Petitions in New York and at the FCC to no longer have obligations to provide wired service and replace it with wireless service, using another non-regulated affiliate company's network, Verizon Wireless. This breaks a requirement, a covenant with customers to provide service that was established as part of the Telecommunications Act of 1934, as we demonstrate below.

But this is only one of many harmful trends.

- Verizon NY has announced that the company has stopped expanding the upgrades to fiber optic services affecting the majority of municipalities in New York State.[1]
- Verizon's plan is to 'shut off the copper' and in areas that were not upgraded, force customers onto wireless service; in upgraded areas they will shut off the copper and force customers onto these upgraded services, in this case FiOS.[2]
- Verizon and AT&T's plan is to 'deregulate', meaning get rid of all regulations, obligations and oversight, and they are doing this state-by-state, as well as at the FCC with AT&T's "IP Transition" proposal.[3]
- In New York State, non-basic service has already been deregulated and there are proposals to eliminate most regulation on basic service. In 2014, Verizon attempted to pass a deregulation bill by slipping it into the State's annual budget.

And the consequences to customers are:

- Prices will continue to rise on all services.
- There will be no high-speed competitive broadband or Internet service.

[1] http://www.fiercetelecom.com/story/verizons-stalled-fios-expansion-will-drive-consumers-cable/2013-12-12
[2] http://www.huffingtonpost.com/bruce-kushnick/are-you-in-a-verizon-or-a_b_3737177.html
[3] http://www.huffingtonpost.com/bruce-kushnick/2014-the-end-game-in-tele_b_4533510.html

- There will be no cable competition in most of the state.
- A lack of serious competition for business customers will get worse as most of the competitors have been relegated to only using the deteriorating copper networks.[4]
- There will be little or no ‘quality of service’ requirements left.
- If the customer’s phone line breaks, VNY will have no obligation to fix it; the customer will either have to accept a wireless substitute or the cable company’s VOIP service, (with the caveat that many cable companies do not sell stand alone local residential telephone service).

This report uses rarely examined, yet publicly available data from Verizon New York’s own financials that have been filed with the SEC, the NYPSC, and the FCC, as the primary source materials to outline an alternative path to stop this deregulatory juggernaut. We believe this never seen before analysis of can be used to return the rights of customers, as well as lower prices, bring choice and competition back for all communications services, and bring very fast fiber optics to the State — and at reasonable rates.

Residential and Business POTS Customers Were Charged for the Development and Deployment of Verizon’s FiOS and Other Affiliates Businesses.

Starting in 2006 through 2009, the New York Public Service Commission agreed to allow Verizon New York multiple rate increases on residential POTS, (Plain Old Telephone Service) utility customers, not to mention on every ancillary service. And alongside this, businesses also had multiple rate increases.

By the end of 2013, these rate increases on POTS customers allowed Verizon to collect an estimated extra $2.4 billion from just the basic “dialtone” charges. On top of this, we estimate an additional $1.4-$2.0 billion was garnered from increases on ancillary services, such as inside wiring, non-published numbers or calling features. Including estimated additional taxes, fees and surcharges, the total added charges since 2006 is estimated to be more than $4.4 billion — and counting.

These increases were granted by the NYPSC because of ‘deployment investments in fiber optics’ and ‘sub-par financial’ results. The State also claimed that these excess increases were being done to align the price of basic telephone service with the underlying ‘costs’ of offering that service.

[4] Because of the previous deregulatory regulations by the FCC, most competitors stopped offering local or DSL service to residential customers around 2005.

It appears, however, that much of the increases were created by transactions with Verizon’s own affiliate companies, such as Verizon Wireless, Verizon Online, and the other Verizon subsidiaries.

Verizon New York has Multiple Financial Books and They Tell Different Stories.

Utility corporations typically maintain separate books for accounting, tax and regulatory purposes. Verizon NY has multiple financial books: there are the state-based SEC-reports that are given to investors, annual reports submitted to the New York Public Service Commission (PSC-Annual) (sometimes referred to as the ‘regulated’ books for the utility networks), and the financial information submitted to the FCC.

- **Black Hole Revenues —** When comparing the SEC and PSC reports of VNY, we found that the SEC-filed report, in 2009, had $2.7 billion dollars more revenues than the PSC-annual report for the same year. The SEC books stated a total revenue of $7.8 billion for 2009 while the PSC regulated books only showed $5.1 billion. We call this difference ‘**black hole revenues’** as there was no description of what is in this ‘financial’ bucket.
- **The FCC’s Data on VNY in the “ARMIS” and “Statistics of Common Carrier”** reports never included any of these extra black hole revenues — i.e., the FCC’s data only matched the regulated books.
- **Data Shut Down** — Not only do the financial books not match in basic information, but the FCC data stopped being published in 2007; the SEC-state-based financials stopped being published in 2010, and the PSC-filed annual reports leaves out an additional 50% of the revenues.
- **Whole Classes of Information Are Non-Existent or Being Manipulated —** When Verizon New York claims it is ‘losing lines’, the only ‘access lines’ that are being counted are the “POTS” lines and it is a subset of all of the other copper and fiber optic lines in use. There is no actual accounting of ‘total lines’ in service, leaving out FiOS lines, DSL lines, or other classes known as ‘special access’, which can be data lines including broadband or Internet services over a copper wire.

FiOS Rides over a Title II, Common Carriage, Fiber Optic Telecommunications Network.

Verizon’s New York City’s current cable franchise, as well as the franchises for other Verizon franchises in other states, from DC to New Jersey — all detail that at the core of Verizon’s cable, Internet and broadband networks is a “Title II”, common carriage, telecommunications service. And it appears this was done for two reasons — it gets all of the powers of the utility, including the rights-of-way that are part of the

telecommunications utility service, but it also may charge the copper-based POTS utility customers for the development and deployment of FiOS.
'Title II' is part of the Telecommunications Act of 1934 (as amended in 1996), and is a classification that is being debated in the current federal communications regulatory environment. A cable TV service is known as "Title VI", while Internet and broadband services are known as "Title I", 'information' services. Each Title dictates the FCC regulations and obligations applied to these services.

'Title I' information services are not open to competitors to use the networks and there are no 'common carriage' obligations. Title I providers generally believe it is their networks to do with what they want. During the last decade, the FCC reclassified broadband as an 'information service', which led to the current "Net Neutrality" discussions. In states, Title I could override the quality of service laws and requirements to offer phone service — because if it is a "Title I" service, it is not telecommunications.

Tracking the Fiber Optic Deployments — Construction Budgets were Placed on the 'Regulated Side'.

Comparing the 2009 SEC and PSC financial reports not only revealed an extra $2.7 billion in the SEC statements for VNY, but the construction budgets for both SEC and PSC reports were almost identical, indicating that the 'black hole revenues' shown in the SEC report were achieved with no major added expense. Apparently, expenses were placed in the 'regulated' books filed with the state commission, but not the associated revenues. This further indicates that POTS customers are paying for the fiber optic construction. Subsequently, there were no further public reports that would allow this comparison.

Massive Losses Reported for the Last Decade: Verizon Paid No Taxes.

Examining publicly available VNY financial reports confirmed that the company has reported losses for over a decade, and they were massive. Over the last five years, Verizon NY showed over $11 billion in losses, about $2.1 billion annually, with an income tax benefit of $1 billion that is used by Verizon Communications, the parent holding company, to offset its tax liabilities. This also means Verizon New York paid no taxes, even though the company had $7.2 billion in revenues in 2010, the last year the information was available.

Verizon Communications' corporate annual reports for the last five years show no losses in wireline services, and in fact they were profitable. However, in examining Verizon's SEC-filed, state-based 4th quarter results for 2010, in four other states — NJ, MA, RI and PA — we found all of these state-based companies reported they were losing money.

Moreover, why are New York's residential POTS customers, who use the aging copper wires, paying rate increases for the development and deployment of FiOS — a cable, phone, broadband and Internet service? And if Verizon Communications, the parent company, showed no losses, how can Verizon's largest state networks be losing billions of dollars annually, with Verizon New York claiming losses of over $11 billion in the last 5 years.

Massive Wireline Financial Losses, Affiliate Transactions

In examining the $11 billion in claimed VNY losses in the last five years, we examined the 'affiliate transactions', which are the revenues paid or monies being charged to Verizon New York from the various Verizon subsidiaries, such as Verizon Online, Verizon Business, or Verizon Wireless, among others.

- **Verizon Wireless** — It would appear that at least a portion of Verizon Wireless's construction budgets for its cell towers were included in the 'wireline' budgets, and also that its use of wires and services known as 'special access' at a significantly discounted rate in comparison to what VNY charges it's wireless competitors.
- **Verizon Services** — are the corporate expenses and other marketing and resources to Verizon NY and it appears to be charging Verizon for everything from the lobbying money used to hire lobbyists to raise customers' rate, or executive pay to even foundation grant money.
- **Special Access Services —** There are multiple financial areas called special access, and the expenses for these services may be disproportionately added to the regulated, local service books. There are also areas that are not regulated and are most likely part of the "black hole revenues".

These large affiliate transactions may be causing the major wireline losses reported by VNY to the NY PSC and there have been no public audits of these transactions by either the state commission or the FCC and yet it the losses were invoked to help win multiple rate increases from POTS customers.

Dissecting the State-Based Utility and the Affiliates.

Verizon New York is the state-based utility, providing what is commonly known as the Public Switched Telephone Network, PSTN. The original copper wires were put in for one service, phone service, and everyone received service as everyone was paying for it. Moreover, over the last 30 years, these wires were supposed to have been replaced with fiber optic lines. As we just discussed, POTS customers have been paying large sums for upgrades — even if they may never get any upgraded service.

Starting in the 1990's the phone companies added new lines of business, including Internet service, (originally via 'dial up'), and broadband service, such as DSL service (which uses the copper wire), long distance service and more recently cable TV service — all traveling over the same wire. However, it appears that the major costs stayed with the regulated POTS customers while the revenues are recorded by separate subsidiaries not paying for full use of the networks or construction, but a fraction of the costs other competitors would pay. More importantly, the POTS customers act as defacto investors for new products, which are moved out of the state regulated 'utility', creating major apparent losses without the customer benefiting.

Moreover, if the costs of the wires are largely paid by one service, why should other services be able to also charge retail — adding $30-$60 dollars per service, but without having to pay for the upgrading and maintaining of the networks. i.e.; cable, broadband and Internet service all get to charge additional retail rates, but their costs are just incremental and a fraction of the retail costs charged to customers.

As we discuss, the Time Warner Cable's financials have a clear version of this. The cable service is paying most of the expenses, while affiliate services, such as high-speed Internet, are only paying incremental charges; the high-speed Internet costs the customer an average of $44.00 but Time Warner Cable's cost to offer the service — as stated in their 2012 annual report —was $1.24 a month.

Verizon's FiOS products appear to have the same cost model. The expenses for capital expenditures were made to be Title II, so that they could have the costs flow into the utility while Verizon Corporate claims that FiOS's profits flow into a separate subsidiary and the 'assets' created, i.e., the FTTP network, Verizon claims is private property for personal use.

But it's worse because one of Verizon's largest 'competitors' is — Verizon. Verizon FiOS Internet and phone competes with Verizon New York's DSL and the utility POTS phone service.

What is the Relationship between Verizon Wireless' Profits and the Wireline Losses?

There has been a multi-year campaign by Verizon to get rid of regulations, not upgrade or maintain the wires and move customers onto the less regulated wireless service — because it makes the company more money, even though this is not better for the cities, states or the customers Verizon serves.

While the other FiOS affiliates for broadband, Internet and cable seem to be causing large losses, and their profits don't appear to be used to upgrade the FTTP, Title II networks,

the plan has been to continuously raise rates to force customers off the copper and onto wireless.
As we discussed, Verizon Corporate has stated that Verizon Wireless’s construction was being paid for by the wireline side — and there are no line items to reimburse VNY for this construction in either the PSC-Annual or SEC-Reports. Also Verizon Wireless appears not to be paying market prices for the use of the VNY networks. In both cases these added expenses lead to the claimed VNY losses, which are then used to justify raised VNY rates.

And because there is no serious local phone competition, POTS customers either get gouged, commonly known as ‘harvesting’, or go to wireless and drop their phone line.

But, there’s a catch. Verizon Wireless not only has 40%-50% of the subscribers of the wireless market, but since Verizon New York owns and controls the ‘special access’ wires, it is in a position to give financial advantages to its affiliate wireless service.

Verizon knows that if the customer drops t wireline, Verizon still makes money on every wireless call, even if the customer goes to another wireless provider. Verizon New York has a monopoly on the “special access” wired services: most competitors are forced to use these services. And the big secret is that even in the non-upgraded areas, where Verizon has claimed that it will ‘kill the copper’, special access wires are not being ‘shut off’.

Verizon also makes money as the wireless company also has a deal with the cable companies to bundle Verizon wireless service with the cable offerings in areas that are not being upgraded to FiOS.

The State has never examined the collusive ties of the wireline and wireless affiliates, nor examined this sub-plot — that Verizon New York and the affiliates have strategically planned steps that have allowed them to continuously a) harvest POTS customers, b) drain the utility that c) raises rates based on losses generated by the affiliates and d) forces customers onto more expensive wireless products and services.

And finally, Verizon uses these ‘massive’ losses to then get rid of regulation, claiming that there is competition and everyone is leaving and going to wireless.

Removing Regulation Via the IP Transition.

On the national level, AT&T seeks the the same result as Verizon. AT&T’s “IP Transition” petition at the FCC claims that everything is going Internet and wireless — and that there is a technology change a foot, but the real goal is to get rid of all regulations. Internet broadband access is classified as ‘Title I”, an ‘information’ service.

And so converting the current telecommunications wires and services to IP is not about a technology change but about shutting off 25% of the copper networks and migrating the customers to wireless using their own special access wired services in their territories. In fact, Verizon and AT&T never competed against each other for wireline services, including special access. They have an apparent ‘truce’ to work on parallel tracks to reduce regulations and customer service obligations.

Over the last five years they have created ‘model’ legislation through a group called the American Legislative Exchange Council (ALEC) that was designed to remove all regulations claiming that ‘the Internet (VoIP) should not be regulated’. That really means the companies should not be regulated. This lets the companies retain control over the wires and whether they can or will ‘shut off the copper’. And the goal is to remove ‘the duty to serve’, meaning no company has an obligation to offer phone service.

With little or no state or federal auditing, investigations or oversight, over 30 states have already deregulated parts, if not all, state-based regulation. In New York non-basic service has been deregulated and efforts have been made to eliminate most regulation on basic service.

Next Steps and Recommendations.

- **Lower Prices —** POTS customers are paying for the development and deployment of FiOS cable, Internet, etc. This includes low income families, small business and municipalities. And it is clear that the losses being outlined and the ‘deployment in fiber optics’ were not done to benefit all POTS customers. Their rates should be lowered because there is no play to deploy more fiber.

- **Audit the Affiliate Transactions and the Flows of Money —** Including all monies from POTS diverted to help fund the wireless deployment. Have Verizon’s FiOS products or Verizon Wireless not paid what other competitors would pay? And were the ‘losses’ caused by Verizon’s wireline affiliates? Without audits we can’t get these answers.

- **Investigate Verizon New York’s Multi-Year Record of Not Paying Income Taxes —** Verizon’s SEC and PSC filings all show that VNY has lost billions and paid no income taxes.

- **Everyone Gets Wired: The FTTP Networks are Part of the State Utility and Common Carriage —** The FTTP networks that FiOS uses are Title II and POTS customers are paying for these networks, not Verizon shareholders. The idea that Verizon New York will pick and choose who gets it, even though they charge every customer extra for it, is contrary to its Title II duty to serve all without discrimination.

- **Audit the Condition of the Copper and have Verizon Maintain the Networks Until They are Upgraded —** It is evident that VNY has failed to properly maintain its networks, and uses this as an excuse to force customers onto wireless or FiOS. The State needs to know what happened and what didn't happen in terms of maintenance and repairs.

- **Ask the FCC to Open the Fiber Optic Networks Immediately —** FiOS is selectively deploying a fiber optic, FTTP, common carriage telecommunications network service, and POTS customers are paying billions for the upgrades. The FCC should investigate the customers' funding of broadband and the commitments to wire entire states or schools and libraries. The FCC should not allow Verizon's affiliate companies to charge content providers more or allow the reclassification of customer-funded fiber optic networks to erase duties of a telecommunications service. When the FCC closed the networks to direct competition and the ability of the companies to buy services at wholesale rates, it never examined the basic issue of who actually is funding the networks**.**

- **We Need More Data —** Basic data is needed, such as the total number of actual lines in service in Verizon New York (and its affiliate) and total revenues. While the State policies rely on "competition", basic service rates probably wouldn't have increased 84% if there were other companies offering standalone local service. After the demise of local competition, there has been no replacement of policies that assumed local phone competition.

- **Surveys are Needed —** How many customers are still using the copper wires? How many are on fiber or are they 'wireless only' **—** meaning no wires at all. The most quoted data by the Center for Disease Control (CDC) examines only residential voice calling and not data lines, like alarm circuits or DSL, and there are no business lines counted.

  If the plan is to start shutting off the copper wires, we need to know how many people are being affected, especially groups that heavily depend on the wires such as seniors and small businesses.

- **Customer Advocacy in Regulatory Proceedings and Upstate-DownState Coordination.** There is no independent State Advocate and New York City's phone rates are set in Albany and deregulation bills are in the State legislature. We need a an independent state-wide advocate's office, as well as a coordinated effort by the New York City Advocate’s Office, to be effective in protecting the rights of ALL residential and business customers.

Long Term

Separate the Affiliates from the Wires.

- The unscrutinized ‘vertical integration’ of Verizon’s affiliates harms the State’s communications infrastructure, economic growth and customers.
- Verizon Wireless, Verizon Online, and Verizon Business should be required to return the FTTP networks, including the special access networks, and all other assets, to the state utility.
- Audit all payments from VNY to Verizon Services and other affiliates, which determine if the utility is profitable.
- The network should be ‘opened’ to all forms of competitors, and it should be a fiber optic-based utility.
- Require Verizon’s affiliate companies using VNY facilities to pay what all of the competitors are paying, and require a fair level of contributions for VNY’s costs.

In short, it is time to restore customers’ rights, choice, lower prices and to provide everyone very-high-speed broadband at reasonable rates.